Investors Focus on Positives, Ignoring Negatives

NUVEEN ASSET MANAGEMENT

WEEKLY INVESTMENT COMMENTARY

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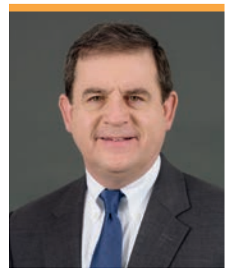
Investor sentiment remained skewed positive last week, helping equity markets rally sharply. The S&P 500 Index surged 3.1%,[1] as the focus remained on prospects for better economic growth, tax reform and potential fiscal stimulus in 2017. For the week, small caps and financials led the way, while health care stocks lagged.[1]

Key Points

- Equity markets continue to rally, with investor sentiment improving since the summer.
- Rising bond yields and the climbing U.S. dollar are potential negatives for equities, but markets have remained resilient so far.
- Despite some clear risks, we retain a pro-growth, pro-risk investment stance.



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Bob Doll serves as a leading member of the equities investing team for Nuveen Asset Management, providing reasoned analysis through equity portfolio management and ongoing market commentary.

What's Behind the Recent Rally?

The current rally appears to have been primarily triggered by November's election results and higher prospects for a pro-growth, pro-business legislative agenda. However, we believe fundamental economic and earnings improvements emerging over the summer are just as important. The rally is also fueled by a not atypical year-end seasonal bounce and investors who may have missed the initial rally adding to positions. For now, investors are looking past issues such as potential negatives from the political environment, elevated sentiment, stretched valuations and possible issues associated with Federal Reserve policy. The broad pro-risk shift will likely continue through year-end and into early 2017.

Weekly Top Themes

1. **Stronger economic data has carried through into November's numbers.** In particular, manufacturing has increased, with Purchasing Manager's Indexes in both the U.S. and Europe moving notably higher.[2]

2. **Positive effects from a new political environment won't be felt right away.** Investors anticipate an economic boost from President-elect Trump's proposed tax, spending and regulatory plans, but given the complexity in rolling out legislation, the economy may not feel the effects until 2018.

3. **Rising economic growth should continue supporting the ongoing equity market leadership shift.** For most of this decade, the slow-growth, low-inflation backdrop benefitted growth stocks, areas of perceived safety and bond-like income sectors of the equity market. If economic growth accelerates and inflation moves higher, we expect such an environment would be advantageous for cyclicals and value stocks.

Factors that Could Derail Equity Markets

Although we have a generally positive view toward the economy, earnings and equity markets, we think it is worth pointing out some possible risks given how quickly and how far markets have moved higher over the past month. To us, the main risk to equity markets is the surge in government bond yields and the rising value of the U.S. dollar. Higher bond yields could create a drag on equity valuations and a higher dollar could put pressure on corporate earnings.

If the current advances in yields and the dollar moderate, equity markets should not experience much damage. So far, equity markets have more-or-less ignored these trends. That might change if they continue or accelerate. Global central bank policy should help as well. While the Fed will almost certainly raise rates this week, central bankers will likely move slowly and remain highly attuned to the risks inherent in higher yields and a stronger dollar. Outside of the U.S., most central banks remain in easing mode, notwithstanding the European Central Bank's decision last week to slightly taper quantitative easing. As a result, we expect any equity market sell-off resulting from a possible yield/dollar spike to be short-lived.

We are also watching possible political negatives from Donald Trump's presidency, such as escalating geopolitical turmoil, currency wars with China or anti-immigration/anti-globalization trends. Additionally, investors may become wary of improving sentiment and less attractive valuations.

Overall, however, we think the environment is improving for pro-growth, risk-on areas of the global financial market. Since the summer, investors have become more sanguine about risks and possible negatives, shifting assets into higher-risk market areas. Unlike the period since the end of the Great Recession, market sell-offs have been brief and followed quickly by strong risk-on moves. As a result of this shift and a seemingly more solid economic and earnings backdrop, we think it makes sense to retain overweight positions in equities. Additionally, we think U.S. markets look more attractive than most areas of the world, despite more expensive valuations due to stronger growth prospects. ■

2016 Performance Year to Date

	Returns	
	Weekly	YTD
S&P 500 Index	3.1%	12.9%
Dow Jones Industrial Average	3.1%	16.4%
NASDAQ Composite	3.6%	10.1%
Russell 2000 Index	5.6%	23.9%
Euro Stoxx 50	4.7%	-1.3%
FTSE 100 (U.K.)	2.5%	-1.0%
DAX Index (Germany)	5.2%	0.7%
Nikkei 225 (Japan)	1.6%	6.3%
Hang Seng (Hong Kong)	0.8%	7.8%
Shanghai Stock Exchange Composite (China)	-0.9%	-12.5%
MSCI EAFE (non-U.S. developed markets)	2.9%	1.1%
MSCI Emerging Markets	2.9%	13.2%
Bloomberg Barclays U.S. Aggregate Bond (bonds)	-0.3%	2.1%
BofA Merrill Lynch 3-Month Treasury Bill (cash)	0.0%	0.3%

Source: Morningstar Direct and Bloomberg, as of 12/9/16. All index returns are shown in U.S. dollars. Past performance is no guarantee of future results. Index performance is shown for illustrative purposes only. Index returns include reinvestment of income and do not reflect investment advisory and other fees that would reduce performance in an actual client account. All indices are unmanaged and unavailable for direct investment.

"Overall, we think the environment for pro-growth, risk-on areas of the global financial market is improving."

For more information or to subscribe, please visit nuveen.com.

1 Source: Morningstar Direct, as of 12/9/16 **2** Source: Markit

The **S&P 500 Index** is a capitalization-weighted index of 500 stocks designed to measure the performance of the broad domestic economy. The **Dow Jones Industrial Average** is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange and the Nasdaq. The **Nasdaq Composite** is a stock market index of the common stocks and similar securities listed on the NASDAQ stock market. The **Russell 2000 Index** measures the performance approximately 2,000 small cap companies in the Russell 3000 Index, which is made up of 3,000 of the biggest U.S. stocks. **Euro Stoxx 50** is an index of 50 of the largest and most liquid stocks of companies in the eurozone.**FTSE 100 Index** is a capitalization-weighted index of the 100 most highly capitalized companies traded on the London Stock Exchange. **Deutsche Borse AG German Stock Index (DAX Index)** is a total return index of 30 selected German blue chip stocks traded on the Frankfurt Stock Exchange. **Nikkei 225 Index** is a price-weighted average of 225 top-rated Japanese companies listed in the First Section of the Tokyo Stock Exchange. **Hong Kong Hang Seng Index** is a free-float capitalization-weighted index of selection of companies from the Stock Exchange of Hong Kong. **Shanghai Stock Exchange Composite** is a capitalization-weighted index that tracks the daily price performance of all A-shares and B-shares listed on the Shanghai Stock Exchange. **MSCI EAFE Index** is a free float-adjusted market capitalization weighted index designed to measure developed market equity performance, excluding the U.S. and Canada. The **MSCI Emerging Markets Index** is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets. **Bloomberg Barclays U.S. Aggregate Bond Index** covers the U.S. investment grade fixed rate bond market. The **BofA Merrill Lynch 3-Month U.S. Treasury Bill Index** is an unmanaged market index of U.S. Treasury securities maturing in 90 days that assumes reinvestment of all income.

RISKS AND OTHER IMPORTANT CONSIDERATIONS

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